

SMEs and their significance in India

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Abstract

SMEs have a crucial role in Indian manufacturing sector and have become engine of economic growth in India. Today, small and medium industry occupies a position of strategic importance in the Indian economic structure due to its significant contribution in terms of output, exports and employment. The small scale industry accounts for 40% of gross industrial value addition and 50% of total manufacturing exports. It is estimated that SMEs account for almost 90% of industrial units in India and 40% of value addition in the manufacturing sector. The present paper is a modest attempt to understand concept of SMEs, their formation and significance in overall growth in India.

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Introduction

SMEs have a crucial role in the Indian manufacturing sector and have become engine of economic growth in India. Today, small and medium industry occupies a position of strategic importance in the Indian economic structure due to its significant contribution in terms of output, exports and employment. The small scale industry accounts for 40% of gross industrial value addition and 50% of total manufacturing exports. More than 3.2 million units are spread all over the country producing about 8000 items, from very basic to highly sophisticated products. The SMEs are the biggest employment-providing sectors after agriculture, providing employment to 29.4 million people. It is estimated that SMEs account for almost 90% of industrial units in India and 40% of value addition in the manufacturing sector. Small industry has been one of the major planks of India's economic development strategy since Independence. The small scale segment is a manifestation of India's socio-economic development model and has met with the country's long-term expectations in terms of contribution to GDP, industrial base, employment and exports. This segment forms a major part of India's industrial base. Small enterprises in India have come up in an unplanned, uncontrolled and haphazard manner. They have emerged anywhere and everywhere – closer to the location of resources as well as markets, in clusters as well as in a dispersed manner, in industrial, commercial and residential areas.

Definition of SMEs

SME's are defined differently in different parts of the world. Some use terms of assets, while others use employment, sales or shareholders funds as criteria to define SMEs. Some others use a combination of employment and revenue as a combined criterion. It is a well-debated issue, but the definition of small and medium enterprises in India was recently settled. The Micro, Small and Medium Enterprises Act, 2006, defines enterprises on the basis of investment in plant and machinery.

According to the new Act, the MSMEs are defines as follows:

Category Investment (Plant & Machinery) Service

Micro Enterprises Less than 25 lacs Less than 10 lacs

Small Enterprises Less than 5 crores Less than 2 crores

Medium Enterprises Less than 10 crores Less than 5 crores

In the European Union, SMEs are defined in the Commission Recommendation of May 6, 2003. An enterprise is regarded as medium sized if it has not more than 250 employees, not more than 50 million Euro turnover and if not more than 25% of the shares of such an enterprise are in the ownership of another enterprise (OECD, 2005). A small enterprise is with 50 employees, not more than 10 million Euro turnover and less than 10 million Euro in balance sheets. The micro enterprises are defined as enterprises with 10 employees, not more than 2 million Euro turnovers and less than 2 million Euro in balance sheet.

Formation of SMES in India

Formation of SMES in India is governed by MSMED Act 2006. The registration under Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 is for aiding the promotion, development and improving the competitiveness of Micro, Small and Medium enterprises.

Registration of a firm under the Act is a means to avail the benefits available to SMEs like easy finance availability from Banks, preference in acquiring Government tenders, stamp duty and octroi benefits, concession in electricity bills, timely receipt of payments from the buyers or debtors, reimbursement of ISO Certification expenses and so on.

All sectors and classes of enterprises, whether Trading, Hindu undivided family, Service or Manufacturing, , Co-operative society, Partnership firm Proprietorship, Association of persons, Company or Undertaking, can apply for the registration and get qualified for the benefits provided under the Act.

Importance of SMES

The contribution of the Small and medium enterprises (SME's) to the economic growth of a nation is well acknowledged. In developing countries, as some authors argue (Leutkenhorst, 2004) the contribution of SME's towards employment generation is significant because they

- use more labour intensive production processes than large enterprises, leading to increase in employment and more equitable income distribution
- Provide livelihood opportunities through simple, value adding processing activities in agriculturally based economies;
- Promote entrepreneurship; and
- Support the building up of productive capacities and the creation of strong economic systems, through linkages between small and large enterprises

The SMEs in India: Present Scenario

In the recent past, small companies have shown better performance than their larger counterpart. Between 2001-06, net companies with net turnover of Rs. 1 crore – 50 crore had a higher growth rate of 701 per cent as compared to 169 per cent for large companies with turnover of over Rs. 1,000 crore (Business World Jan. 2007). The total SSI production, reached the all time high of Rs. 1,89,200 crores in 1989-90 but dropped significantly in the next 10 years and only in 2001-02 the level of production improved. But after 2002, the production has risen rapidly. Since 2000, there is a uninterrupted increase in number of units, employment, production and in exports. The average annual growth in the number of units was around 4.1%.

Today, some of the SMEs are also acquiring companies in foreign countries as part of their growth strategy and globalization process. Mostly, these units are export oriented and are ancillaries. The SME sector have changed and adapted to the need of large local manufacturers and suppliers to global manufacturers like Auto Industry. Today some SMEs are also investing in R&D in order to survive and excel in this global economy. Outsourcing from foreign companies has played a crucial role in the emergence of Indian SMEs as world leaders in particular products. The advantages in labour-intensive manufacturing units, lower transport costs, lower labour costs and easy labour policies of the SMEs have led to major outsourcing in manufacturing and services. The SME's alone contribute to 7% of India's GDP. The third All India Census of Small Scale industries conducted in 2004, revealed that the number of SME's have increased from about 80,000 units in 1940's to about 10.52 million units in 2004. The statistics show that they produce about 7500 products including high technology products and their employment is about 25 million. In the garments sector and sports goods their contribution to exports is as high as 90% to 100%. They constitute 90% of the industrial units in the country and also contribute to about 35% of India's exports. (Pandey, 2007)

The Government of India since 1951 through its various policy initiative and different incentives has always encouraged and supported the SME's. Since 2005, The Government of India has marked 3,000 SME clusters of artisan-specific, village and small enterprises in the country and has shortlisted 1,150 such clusters for improvement and intervention. The performance of the Indian small scale

sector in terms of critical economic parameters such as , production , number of units, employment and export during the last decade is indicated below .

| Year | No.of units | Production | Employment | Export |
|---------|-------------|------------|------------|--------|
| 2000-01 | 3.37 | 6454.96 | 18.56 | 599.78 |
| 2001-02 | 3.46 | 6905.22 | 19.22 | 712.44 |
| 2002-03 | 3.67 | 8243.63 | 20.07 | 861.03 |
| 2003-04 | 3.83 | 9323.54 | 20.90 | NA |
| 2004-05 | 4.00 | 10600.87 | 22.78 | NA |
| 2005-06 | 4.18 | 12138.00 | 22.78 | NA |
| 2006-07 | 4.37 | 141019.39 | 22.17 | NA |

(Source: Pandey, 2007)

Conclusion

The international and national policy changes have opened new opportunities and markets for the SMEs in India. Integrated and unified effort is required from the small industry and government to understand and absorb technological dynamism. Technological up gradation , Research and Development and encouragement of inter-firm linkages need to be promoted purposely and consistently. Financial infrastructure needs to be enhanced and sufficient credit to the sector be made available taking into consideration the growing investment demand, globalization, increasing competition and the requirements of technological transformation. It is important to take care of the sector to enable it to contribute towards growth in the Indian economy.

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